

# **Audit Report**

## **Ikwezi Municipality**

For the Year ended 30 June 2012

# **REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON IKWEZI LOCAL MUNICIPALITY**

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I was engaged to audit the financial statements of the Ikwezi Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2012, the statements of financial performance, changes in net assets and cash flows for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2011 (Act No. 6 of 2011) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-General's responsibility**

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### **Basis for disclaimer of opinion**

#### **Property, plant and equipment**

4. In terms of section 63 of the MFMA the municipality is required to maintain a system of internal control and register of assets and liabilities. I was unable to obtain sufficient appropriate audit evidence to confirm the valuation, existence and classification of land and buildings within property, plant and equipment, stated at a cost of R19,6 million. In addition, I was unable to obtain sufficient appropriate audit evidence to confirm the existence of movable assets within property, plant and equipment, stated at a cost of R46,8 million. The municipality could not provide a fixed asset register with sufficient detail of descriptions, locations and references that correlated to the physical assets. The physical assets were not tagged to correlate to the fixed asset register. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments to land and buildings and movable assets were necessary.
5. Furthermore, not all immovable assets, per the deed search, were recorded in the fixed asset register. I was unable to verify the completeness by alternative means. Consequently, I was unable to determine whether any adjustments to immovable assets were necessary.
6. The municipality did not review the specialised underground water-piping infrastructure assets for indicators of impairment at each reporting date, in accordance with GRAP 17, *Property, plant and equipment*. I was unable to confirm the valuation of the impairment. This is due to the fact that the municipality does not review the useful lives and residual

values of its property, plant and equipment at year end, as required by GRAP 17, *Property, plant and equipment*. Consequently, I was unable to determine whether any adjustments to immovable assets were necessary.

7. GRAP 17, *Property, plant and equipment* requires assets to be disclosed per category. The municipality disclosed completed capital projects to the value of R26,3 million as capital work in progress per note 7 to the financial statements. I was unable to confirm the valuation, existence and allocation per category of property, plant and equipment by alternative means. Consequently I was unable to determine whether any further adjustments were necessary to the amount disclosed for capital work in progress.
8. Prior year capital work in progress projects of R9,4 million (restated in the current year to R20,3 million) disclosed in note 6 to the financial statements that were completed during the year per the fixed asset register did not agree to the amount per the listing of completed projects submitted for audit. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments to prior year capital work in progress assets were necessary.

#### **Investment property**

9. In terms of section 63 of the MFMA the municipality is required to maintain a system of internal control and register of assets and liabilities. I was unable to obtain sufficient appropriate audit evidence to confirm the valuation, existence, classification and presentation and disclosure of investment property, stated at a fair value of R26,2 million. Furthermore, not all investment properties, per the deed search, were recorded in the investment property register. I was unable verify the completeness by alternative means. Consequently, I was unable to determine whether any adjustments to investment property were necessary. I was unable to obtain sufficient appropriate audit evidence for the restatement in the corresponding figure of investment property, as described in note 8 to the financial statements as this note reflects that the restatement of R1,4 million was made in order to rectify a prior year misstatement. I was unable to confirm the restatement by alternative means. Consequently I was unable to determine whether any adjustments to the investment property and accumulated surplus were necessary. Furthermore, the municipality did not disclose this restatement as a prior period error as required by GRAP 3, *Errors, changes in accounting policies and estimates*.

#### **Commitments**

10. The municipality did not have a contract management system in place for the identification and recognition of contracted commitments and did not include items that represent commitments of the municipality in the amounts disclosed in note 31 to the financial statements. The commitments disclosed relate to expenditure incurred in the current year and not expenditure committed for the coming financial period. I was unable to confirm the commitments by alternative means. Consequently, I was unable to determine whether any adjustments to the commitments note were necessary.

#### **Provision for landfill site**

11. Sufficient appropriate audit evidence could not be presented to support the recognition and measurement of the landfill site provision of R8,4 million (2011: R8,4 million) as disclosed in note 13 and the landfill site asset of the same amounts as disclosed in note 7 to the financial statements. I was unable to confirm the balances by alternative means. Consequently, I was unable to determine whether any adjustments to the landfill site asset and related provision were necessary.

### **Inventory**

12. The municipality did not have a system in place for the recognition of water inventory as no water inventory was reported or disclosed by the municipality at 30 June 2012 or at 30 June 2011 as required by GRAP 12, *Inventories*. I was unable to confirm the balance by alternative means as it was impracticable to do so. Consequently, I was unable to determine whether any adjustments to inventories and accumulated surplus were necessary.

### **Trade and other payables from exchange transactions**

13. Sufficient appropriate audit evidence could not be presented to support journal entries and the retention balance included together with trade and other payables from exchange transactions of R10,5 million (2011: R7,8 million) as disclosed in note 11 to the financial statements. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments to trade and other payables from exchange transactions and accumulated surplus were necessary.
14. The financial statements as a whole are further materially misstated due to the cumulative effect of a number of individually immaterial uncorrected misstatements in trade and other payables from exchange transactions of R10,5 million as disclosed in note 11 to the financial statements. Trade and other payables from exchange transactions are overstated by R100 312.

### **Cash and bank**

15. Sufficient appropriate audit evidence could not be presented to support journal entries processed to cash and bank of R331 456, and to bank overdraft of R1,3 million as disclosed in note 3 to the financial statements. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments to cash and bank were necessary.
16. The financial statements as a whole are further materially misstated due to the cumulative effect of a number of individually immaterial uncorrected misstatements in cash and bank of R331 456, and to bank overdraft of R1,3 million as disclosed in note 3 to the financial statements. Cash and bank is overstated by R65 145.

### **Trade receivables from exchange transactions**

17. Receivables amounting to R9,9 million and the provision for bad debts amounting to R9,8 million as disclosed in note 4 to the financial statements do not reconcile with the receivables age analysis. Provision for debt impairment of R9,8 million disclosed in note 4 is not correctly measured in terms of International Accounting Standards (IAS) 39, *Financial instruments*, recognition and measurement as the municipality provides for all outstanding receivables in excess of 120 days. Included in trade receivables are adjustments for writing off of irrecoverable receivables of R2,7 million and the reduction of the opening balance of the provision for debt impairment for which adequate supporting documentation could not be provided. Sufficient appropriate audit evidence was not available and I was unable to confirm the valuation, existence and completeness of receivables and the provision for debt impairment by alternative means. Consequently I was unable to determine whether any further adjustments were necessary to the amounts disclosed for receivables, and provision for debt impairment.
18. The municipality did not recognise interest on outstanding debtors at the correct interest rate. Consequently, revenue from exchange transactions is overstated by R449 624 and trade receivables from exchange transactions are overstated by the same amount.

19. The financial statements as a whole are further materially misstated due to the cumulative effect of a number of individually immaterial uncorrected misstatements in trade receivables from exchange transactions of R1,3 million as disclosed in note 4 to the financial statements. Trade receivables are understated by R34 400.

**Other receivables from non exchange transactions**

20. Included in sundry receivables of R1,8 million, as disclosed in note 5 to the financial statements, are various receipts and payments for which no support could be presented to confirm the recoverability of the balances. I was unable to confirm the valuation of the balances by alternative means. Consequently, I was unable to determine whether any adjustments to other receivables from non exchange transactions were necessary.

**Value added taxes (VAT)**

21. Sufficient appropriate audit evidence could not be presented to support journal entries processed to the VAT receivable balance of R334 305 as disclosed in note 6 to the financial statements. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments to VAT receivable were necessary.
22. During 2011, VAT amounts were incorrectly processed in the general ledger as input VAT and output VAT was not always claimed on expenses incurred and revenue recognised. This resulted in expenditure being overstated by R739 456, revenue being overstated by R617 630 and the VAT receivable being understated by R121 826. Consequently, the surplus for the prior period and the opening accumulated surplus are understated by R121 826 respectively. In addition, the municipality was unable to reconcile the VAT receivable of R1,4 million in the prior year, as disclosed in note 6 to the financial statements, to the returns submitted to the South African Revenue Services (SARS). I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments to the current or prior year VAT receivable balances were necessary. My audit opinion on the financial statements for the period ended 30 June 2011 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.
23. The financial statements as a whole are further materially misstated due to the cumulative effect of a number of individually immaterial uncorrected misstatements in the VAT receivable of R334 305 million as disclosed in note 6 to the financial statements. The VAT receivable is understated by R24 443.

**Unspent conditional grants**

24. Unspent conditional grants, as disclosed in note 12 to the financial statements, is understated by R5,3 million as a result of receipts being allocated directly to revenue.
25. Unspent conditional grant liability amounting to R3,6 million as disclosed in note 12 to the financial statements does not reconcile with the unspent conditional grant reconciliation. Included in the balance were receipts for which sufficient appropriate audit evidence could not be presented and capital expenditure which was not complete. I was unable to confirm the valuation, existence and completeness thereof by alternative means. Consequently I was unable to determine whether any further adjustments were necessary to the amount disclosed for unspent conditional grant liability. Furthermore, the municipality did not disclose the unspent conditional grant liability in accordance with GRAP 23, *Revenue from non-exchange transactions*, as a separate reconciliation of the outstanding liability for each conditional grant was not included in the financial statements.



26. Grant expenditure of R453 718 and grant revenue of R12,2 million as disclosed in the statement of financial performance and note 14 to the financial statements respectively does not reconcile to the unspent conditional grant reconciliation. I was unable to confirm the accuracy, occurrence and completeness thereof by alternative means. Consequently I was unable to determine whether any further adjustments were necessary to the amount disclosed for conditional grant expenditure and conditional grant revenue.
27. Furthermore, the municipality did not disclose a prior period error of R1,6 million in the financial statements as required by GRAP 3, *Errors, changes in accounting policies and estimates*.
28. The municipality has failed to disclose an overspent grant, of R1 million, as a receivable in the financial statements, as required by GRAP 1, *Presentation of financial statements*.

#### **Accumulated surplus**

29. Sufficient appropriate audit evidence could not be presented to support journal entries processed to the accumulated surplus of R58,6 million (2011: R78,6 million, restated to R50 million) as disclosed in the statement of changes in net assets. I was unable to confirm the valuation, existence and completeness of the balance by alternative means. Consequently, I was unable to determine whether any adjustments to the opening and closing balances of accumulated surplus were necessary.
30. The financial statements as a whole are further materially misstated due to the cumulative effect of a number of individually immaterial uncorrected misstatements in accumulated surplus, of R58,6 million as disclosed in the statement of changes in net assets. Accumulated surplus is overstated by R14 014.

#### **Revenue from exchange transactions**

31. Sufficient appropriate audit evidence could not be presented to support journal entries processed to revenue from exchange transactions of R9,7 million as disclosed in notes 16 and 18 to the financial statements. Furthermore, revenue from exchange transactions does not reconcile to the revenue sub ledger and is not complete. I was unable to confirm the accuracy, occurrence and completeness by alternative means. Consequently, I was unable to determine whether any further adjustments to revenue from exchange transactions were necessary.
32. The municipality did not recognise electricity revenue at the correct tariff as required by GRAP 9, *Revenue from exchange transactions*. Consequently, revenue from exchange transactions is overstated by R153 102 and the surplus for the period is overstated by the same amount
33. The municipality has not disclosed revenue from the sale of electricity and water, as disclosed in note 18 to the financial statements, as revenue received from the sale of goods. The disclosure is not in terms of the GRAP 9, *Revenue from exchange transactions*.

#### **Goods and services**

34. The municipality did not provide adequate supporting documentation for payments made or journals passed during the year for grant expenditure of R453 718 (2011: R Nil), bulk purchases of R5 million (2011: R Nil), repairs and maintenance of R1 million (2011: R989 858) and general expenditure of R10,8 million (2011: R17,1 million) as disclosed in the statement of financial performance. I was unable to confirm this expenditure by alternative means. Consequently, I was unable to determine whether

any further adjustments relating to goods and services in the financial statements were necessary.

35. During 2011, I was unable to obtain sufficient appropriate audit evidence about the classification of expenditure of R17,5 million (Restated to R17,1 million) as disclosed on the statement of financial performance and in note 23 to the financial statements. I was unable to confirm the classification, occurrence, accuracy and completeness of the expenditure by alternative means. Consequently I was unable to determine whether any adjustments to expenditure and to the accumulated surplus were necessary. My audit opinion on the financial statements for the period ended 30 June 2011 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.
36. I was unable to obtain sufficient appropriate audit evidence for the restatement in the corresponding figure of the loss on disposal of assets and general expenditure, as described in the statement of financial performance. This statement reflects that restatements of R392 895 and R384 395, respectively, were made in order to rectify prior year misstatements. I was unable to confirm the restatement by alternative means. Consequently I was unable to determine whether any adjustments to general expenditure and accumulated surplus were necessary.
37. Furthermore, the municipality did not disclose this restatement as a prior period error as required by GRAP 3, *Errors, changes in accounting policies and estimates*.

#### **Employee related cost**

38. Sufficient appropriate audit evidence could not be presented for employee related cost of R13 million (2011: R11,3 million) as disclosed in the statement of financial performance. Documentation in support of travel and subsistence payments, retirement benefit obligation and long service awards was either not submitted for audit purposes or that which was submitted, was incomplete. Furthermore the total employee costs disclosed in the statement of financial performance does not reconcile by a significant amount to the payroll system of R12,7 million. I was not able to confirm the employee related cost by alternative means. Consequently, I was unable to determine whether any adjustments to the employee related cost were necessary.
39. The financial statements as a whole are further materially misstated due to the cumulative effect of a number of individually immaterial uncorrected misstatements in the leave pay provision and the bonus provision, of R733 999 and R223 580 respectively, as disclosed in note 13 to the financial statements. Leave pay provision is understated by R57 502 and bonus provision is overstated by R181 230.

#### **Irregular expenditure**

40. The municipality did not include particulars of irregular expenditure in the notes to the financial statements as required by section 122(1)(b) of the MFMA. The municipality made payments in contravention of the supply chain management requirements, which were not included in irregular expenditure, resulting in irregular expenditure being understated by R9,5 million (2011: R31,1 million), while the opening balance for 2010-11 is also understated by R8,2 million in this regard. Due to the lack of systems in place, it was impracticable to determine the full extent of the understatement of irregular expenditure disclosed at R497 227 (2011: R22,9 million). Consequently, I was unable to determine whether any further adjustments were necessary to the irregular expenditure disclosure note.

### **Fruitless and wasteful expenditure**

41. The municipality did not include particulars of fruitless and wasteful expenditure in the notes to the financial statements as required by section 122(1)(b) of the MFMA. The municipality incurred interest due to late payment in respect of compensation of services, which was not included in fruitless and wasteful expenditure, resulting in fruitless and wasteful expenditure being understated by R80 641 (2011: R69 120). Due to the lack of systems in place it was impracticable for me to determine the full extent of this understatement. Consequently, I was unable to determine whether any further adjustments were necessary to fruitless and wasteful expenditure disclosure note.

### **Unauthorised expenditure**

42. The municipality did not include particulars of unauthorised expenditure in the notes to the financial statements as required by section 122(1)(b) of the MFMA. The municipality exceeded the budget per vote, which was not included in unauthorised expenditure, resulting in unauthorised expenditure being understated by R2,7 million (2011: R5,6 million), while the opening balance for 2010-11 is also overstated by R4,4 million in this regard. Due to the lack of systems in place, it was impracticable to determine the full extent of the understatement of unauthorised expenditure disclosed at R0 (2011: R10 million). Consequently, I was unable to determine whether any further adjustments were necessary to the unauthorised expenditure disclosure note.

### **Budget information**

43. GRAP 1, *Presentation of financial statements*, paragraph 12, requires that the budgeted figures should be disclosed as part of the financial statements and not as an unaudited annexure and paragraph 38 states that the budgetary basis and classification basis adopted in the approved budget must be disclosed. The municipality did not disclose the basis on which the budget is prepared and did not include the budget as part of the financial statements.

### **Cash flow statement**

44. GRAP 2, *Cash flow statements*, requires the presentation of a cash flow statement, summarising the entity's operating, investing and financing activities. The accuracy of the cash flow statement for the current and prior year could not be confirmed due to the limitations imposed by the lack of sufficient appropriate audit evidence as included in this report.

### **Basis of presentation**

45. GRAP 1, *Presentation of financial statements* stipulates that an entity can only achieve fair presentation in its financial statements where it complies with all the applicable disclosures prescribed by the Standards of GRAP. Ikwezi Local Municipality did not make the following disclosures as required by the Standards of Generally Recognised Accounting Practice:

- GRAP 1, *Presentation of financial statements*: The significant judgements and sources of estimation uncertainty disclosed by the municipality are not relevant to the entity. The entity has not disclosed a description of the nature of those significant judgements and estimations made by the municipality. The disclosure of standards, amendments to standards and interpretations issued but not yet effective does not include when these standards and interpretations are expected to impact the municipality and does not include a list of iGRAP interpretations. The municipality did not disclose the reasoning for the preparation of the financial statements on the going concern basis, even though it does not appear that the municipality is able to settle its obligations as they fall due. The municipality did not disclose the details regarding the frequency of the



valuation of property, the details of the valuator or the details of the last valuation performed.

- GRAP 23, *Revenue from non-exchange transactions*: The aging of receivables related to municipal rates was included in note 4 as part of the trade and other receivables from exchange transactions. This disclosure of the aging, related to municipal rates, arises from non-exchange transactions and should therefore be disclosed as part of note 5 other receivables from non-exchange transactions. The reconciliation of debt impairment provision relating to trade and other receivables from exchange transactions includes contributions related to property rates. This contribution relates to non-exchange transactions and should therefore be disclosed as part of the reconciliation of debt impairment in note 5, other receivables from non-exchange transactions.
- GRAP 3, *Errors, changes in accounting policies and estimates*: This standard requires that the entity disclose the nature of the prior period error, for each prior period presented, to the extent practicable, the amount of the correction for each financial statement line item affected, the amount of the correction at the beginning of the earliest prior period presented; and if retrospective restatement is impracticable for a particular prior period, the circumstances that led to the existence of that condition and a description of how and from when the error has been corrected. Numerous prior year errors and restatements, as detailed in the individual paragraphs above, were not disclosed, in a prior period error note in, the financial statements by the entity.
- GRAP 20, *Related party disclosures*: The municipality has failed to disclose its related parties as per the standard.
- GRAP 16, *Investment property*: The municipality has failed to disclose the amounts included in surplus or deficit for direct operating expenses (including repairs and maintenance) arising from investment property that generated rental revenue during the period, direct operating expenses (including repairs and maintenance) arising from investment property that did not generate rental revenue during the period, and the cumulative change in fair value recognised in surplus or deficit on a sale of investment property from a pool of assets in which the cost model is used into a pool in which the fair value model is used.
- GRAP 19, *Provisions*: The municipality has failed to disclose a narration for each provision explaining the uncertainty involved in the provision and what the obligating event is and what assumptions / estimates were made in the measurement of the provision.
- GRAP 9, *Revenue from exchange transactions*: The municipality has failed to disclose the material amounts of "Other income", as per the statement of financial performance, in the notes to the financial statements.
- IFRS 7, *Financial instruments: disclosures*: The municipality has failed to disclose a maturity analysis of financial liabilities. The municipality did not disclose an analysis of receivables passed due but not impaired. The municipality has not disclosed the extent to which the municipality has access to undrawn facilities should the need arise in future, the extent to which there are any restrictions on the ability to realise cash balances, the credit quality of cash and cash equivalents and whether or not any cash balances have been pledged as security for liabilities. The entity has not disclosed whether trade date or settlement date is applied in relation to the recognition of financial instruments. The municipality did not adequately disclose liquidity risk, in sufficient detail. The municipality did not disclose the maximum exposure to credit risk posed by its financial instruments. The municipality did not disclose the credit quality of its financial instruments or the methods used to determine the credit quality of these financial instruments.

- GRAP 17, *Property, plant and equipment*: The municipality has disclosed a reconciliation of the carrying amount from the beginning of 2010-2011 to the end of 2010-2011 of all classes of assets, however, the municipality has not disclosed the movement with adequate descriptions.
- GRAP 102, *Intangible assets*: The municipality has disclosed a reconciliation of the carrying amount from the beginning of 2010-2011 to the end of 2010-2011 of intangible assets, however, the municipality has not disclosed the movement with adequate descriptions.

#### **Disclaimer of opinion**

46. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

#### **Emphasis of matters**

47. I draw attention to the matters below. My opinion is not modified in respect of these matters.

#### **Restatement of corresponding figures**

48. Notes 7, 14 and 25 to the financial statements for the year ended 30 June 2012 have been restated for purposes of a new reporting framework used by the municipality and the application of Directive 7 in the current year.

#### **Financial sustainability**

49. Note 35 to the financial statements indicates that the municipality's current liabilities exceeded its total current assets by R13 million. These conditions indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to settle its accounts as they fall due, and therefore to operate as a going concern.

#### **Significant uncertainties**

50. With reference to note 13 to the financial statements, the municipality has 2 active landfill sites which are not licensed as required by the National Environmental Management Waste Act, 2008 (Act No. 59 of 2008). The municipality has taken steps to obtain the required licenses. The ultimate outcome of the matter cannot presently be determined, and no provision for any liability that may result has been made in the financial statements.

#### **Material losses and impairments**

51. The municipality suffered a significant electricity loss of 1,4 million units with a value of R1,7 million during the year under review.
52. The municipality had receivables for consumer debtors totalling R12 million at 30 June 2012, which had been outstanding for more than 12 months. The recoverability of these amounts is doubtful as disclosed in the financial statements.

#### **Withdrawal from the audit engagement**

53. Due to the limitation imposed on the scope of the audit by management, I have disclaimed my opinion on the financial statements. But for the legislated requirement to perform the audit of the municipality, I would have withdrawn from the engagement in terms of the International Standards of Auditing.

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

54. In accordance with the PAA and the General Notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

### **Predetermined objectives**

55. The annual performance report included in the annual report was not presented in time for audit and consequently our findings below are limited to the procedures performed on the strategic planning and performance management documents.
56. The information was assessed to determine whether performance indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury Framework for managing programme performance information (FMPPI).

The material findings are as follows:

### **Usefulness of information**

#### **Measurability**

##### **Performance targets are not specific**

57. The FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 100% (>20%) of the targets were not specific in clearly identifying the nature and the required level of performance. This was due to the fact that management did not submit an annual performance report for audit.

##### **Performance targets are not measurable**

58. The National Treasury FMPPI requires that performance targets be measurable. The required performance could not be measured for a total of 100% (>20%) of the targets. This was due to the fact that management did not submit an annual performance report for audit.

##### **Performance targets are not time bound**

59. The National Treasury FMPPI requires that the time period or deadline for delivery be specified. A total of 100% (>20%) of the targets were not time bound in specifying a time period or deadline for delivery. This was due to the fact that management did not submit an annual performance report for audit.

##### **Performance indicators are not well defined**

60. The National Treasury FMPPI requires that indicators/measures should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 100% (>20%) of the indicator were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the fact that management did not submit an audit report for audit.

##### **Performance indicators are not verifiable**

61. The National Treasury FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. A total of 100% (>20%) of the indicators were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the fact that management did not submit an annual performance report for audit.

### **Compliance with laws and regulations**

62. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the General Notice issued in terms of the PAA are as follows:

### **Strategic and performance management**

63. The municipal council did not consult with the local community in the drafting and implementation of the municipality's integrated development plan (IDP), through a forum that enhances community participation, as required by section 28 of the Municipal Systems Act (Act No. 32 of 2000) (MSA) and Local Government: Municipal Planning and Performance Management Regulations (MPPMR) 15(1)(a)(i).
64. The performance management system was not in line with the priorities, objectives, indicators and targets contained in its integrated development plan and did not clarify the roles and responsibilities of each role-player in the functioning of the system and did not determine the frequency of reporting and the lines of accountability for performance and did not relate to the municipality's performance management processes and did not provide for procedures by which the system is linked to the municipality's integrated development planning processes, as required by section 38 (a) of the MSA and MPPMR 7(2), (c), (e), (f) and (g).
65. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
66. The municipality did not monitor performance, with regard to each of those development priorities and objectives and against the key performance indicators and targets set, measure and review performance at least once per year, with regard to each of those development priorities and objectives and against the key performance indicators and targets set, take steps to improve performance with regard to those development priorities and objectives where performance targets are not met as required by section 41 of the MSA.
67. The municipality did not adopt and did not implement a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players as required by section 38, 39, 40 and 41 of the MSA read with regulations 7 and 8 of the MPPMR.
68. The accounting officer of the municipality did not by 25 January assess the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan as required by section 72(1)(a)(ii) of the MFMA.

### **Budgets**

69. The annual budget of the municipality could not be based on the development priorities and objectives as well as the performance targets set by the municipality in its IDP as required by regulation 6 of the MPPMR, 2001.
70. Expenditure was incurred that was not budgeted for, in contravention of section 15 of the MFMA.



71. The accounting officer did not assess the first half of the financial year performance of the municipality, as required by section 72(1) and 72(1)(a)(ii) of the MFMA.

#### **Financial statements, audit and performance reports**

72. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current assets, liabilities, revenue, expenditure and disclosure items identified by the audit process in the submitted financial statements were subsequently corrected and certain supporting records requested were subsequently provided. However, the effects of uncorrected material misstatements and of supporting records that could not be presented for audit resulted in the financial statements receiving a disclaimer audit opinion.
73. The accounting officer did not make public the council's oversight report on the 2010-11 annual report within seven days of its adoption, as required by section 129(3) of the MFMA.
74. The annual performance report did not contain a comparison of the performance of the municipality and of each external service provider with development priorities, objectives and performance indicators set out in its integrated development plan as required by section 46 of the MSA.
75. The performance report for the financial year under review was not prepared as required by section 46 of the MSA read with section 121(3)(c) of the MFMA.
76. The financial statements were not approved by the municipal manager as required by section 126(1) of the MFMA.
77. Detailed disclosure of salaries, allowances and benefits, for all political office bearers and councillors of the municipality, was not included in the financial statements as required by section 124 of the MFMA.

#### **Audit committee**

78. The audit committee did not respond to the council on the issues raised in the audit reports of the Auditor-General, as required by section 166(2)(c) of the MFMA.
79. The performance audit committee did not submit at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by MPPMR 14(4)(a)(iii).

#### **Internal audit**

80. The internal audit unit did not submit quarterly reports on their audits to the municipal manager and the performance audit committee, as required by MPPMR 14(1)(c).

#### **Asset management**

81. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
82. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

#### **Revenue management**

83. An adequate management, accounting and information system was not in place which recognised revenue when it was earned / accounted for debtors / accounted for receipts of revenue, as required by section 64(2)(e) of the MFMA.

**Liability management**

84. A management, accounting and information system which adequately accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.
85. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.

**Expenditure management**

86. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
87. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, accounted for creditors and recorded payments made, as required by section 65(2)(b) of the MFMA.
88. The accounting officer did not take effective steps to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
89. Unauthorised, irregular and fruitless and wasteful expenditure was not recovered from the liable person, as required by section 32(2) of the MFMA.
90. The relevant disclosure, for unauthorised, irregular and fruitless and wasteful expenditure as required by section 125 of the MFMA was not included in the notes to the financial statements.
91. Irregular expenditure was not condoned by National Treasury as per section 170 of the MFMA.
92. With reference to note 13 to the financial statements, the municipality has 2 active landfill sites which are not licensed as required by the National Environmental Management Waste Act, 2008 (Act No. 59 of 2008). The municipality has taken steps to obtain the required licenses. The ultimate outcome of the matter cannot presently be determined, and no provision for any liability that may result has been made in the financial statements.

**Procurement and contract management**

93. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) and (c).
94. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a).
95. Disclosure, of reasons of any deviation from the SCM process, in terms of paragraph 36(1), was not included in the notes to the financial statements as required by paragraph 36(2) of the SCM regulations.
96. Sufficient appropriate audit evidence could not be obtained that bid specifications for procurement of goods and services through competitive bids were drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as per required by SCM regulation 27(2)(a).
97. Invitations for competitive bidding were not always advertised for a required minimum period of days, as required by SCM regulation 22(1) and 22(2).

98. Sufficient appropriate audit evidence could not be obtained that contracts were awarded to bidders based on points given for criteria that were stipulated in the original invitation for bidding due to the bid adjudication committee, as required by SCM regulations 21(b) and 28(1)(a) and preferential procurement regulations due to the bid adjudication committee minutes not being presented for audit.
99. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
100. The preference point system was not applied in all procurement of goods and services above R200 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act (PPPFA) and SCM regulation 28(1)(a).
101. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
102. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
103. Contracts were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).

#### **Conditional grants received**

104. The municipality did not evaluate its performance in respect of programmes funded by the allocation and submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(6) of the DoRA.
105. Unspent conditional grant funds not committed to identifiable projects and not approved by the National Treasury for retention were not surrendered to National Revenue Fund, as required by section 20(1) of the DoRA.
106. The municipality did not disclose whether or not the conditions attached to the conditional grants received were complied with or not, or how each grant has been spent, as required by section 123 of the MFMA, in the financial statements.

#### **Internal control**

107. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for disclaimer of opinion, the findings on the annual report performance report and the findings on compliance with laws and regulations included in this report.

#### **Leadership**

108. Management does not exercise oversight responsibility regarding financial and performance reporting and compliance and related controls. Non compliance with the MSA, MFMA, DoRA as well as the SCM regulations, numerous control deviations were noted throughout the audit.
109. Management does not implement effective HR management to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored, as evidenced by lack of supporting documentation and misstatements.

110. Management does not establish and communicate policies and procedures to enable and support understanding and execution of internal control objectives, processes and responsibilities. Human resource management, information technology, Related parties, post balance sheet events and grants and subsidies policy and procedural documents do not exist and/or are not implemented.

#### **Financial and performance management**

111. Management does not implement proper record keeping in a timely manner to ensure that complete relevant and accurate information is accessible and available to support financial and performance information. No supporting documentation was supplied for property, plant and equipment, landfill site provision, other provisions, investment property, VAT receivable, cash and cash equivalents, trade payables, unspent conditional grant liability, accumulated surplus, revenue and expenditure and for the audit of predetermined objectives.
112. Management does not implement controls over daily and monthly processing and reconciling of transactions. Reconciling differences between the financial statements and the applicable sub-ledgers/registers were reported on capital projects, revenue, grant revenue, grant expenditure and unspent conditional grant liability and payroll.
113. Management does not prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information. Incomplete and inaccurate information was submitted for the audit of property, plant and equipment revenue, employee costs, employee related provisions, expenditure and investment property.
114. Management does not review and monitor compliance with applicable laws and regulations. There are numerous findings on non-compliance with the MSA, MFMA, DoRA as well as the SCM regulations was reported.

#### **Governance**

115. Management does not implement appropriate risk management activities to ensure that regular risk assessments, including consideration of IT risks and fraud prevention, are conducted and that a risk strategy to address the risks is developed and monitored.

*Auditor General*

East London

30 November 2012



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*